

**Does a mineral right
constitute ‘immovable
property’ for purposes of
the Income Tax Act and
double tax treaties?**

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fulfilment of the requirements for the
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1 Declaration

Research dissertation presented for the approval of Senate in fulfilment of part of the requirements of MPhil in approved courses and a minor dissertation. The other part of the requirement for this qualification was the completion of a programme of courses.

I hereby declare that I have read and understood the regulations governing the submission of MPhil dissertations including those related to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

Preshnee Govender

28 February 2014

2 **Abbreviations and glossary**

CGT	Capital gains tax
CSARS	Commissioner for the South African Revenue Service
DTA / tax treaty	Double Tax Agreement / Double Tax Convention
ITA	Income Tax Act No.58 of 1962 (as amended)
OECD	Organisation for Economic Co-operation and Development
OECD Commentary	Commentary on the OECD Model on Income and on Capital
OECD Model	OECD Model Tax Convention
1991 Minerals Act	Minerals Act No.50 of 1991, as amended
Mineral right	Encompasses a prospecting right and a mining right in respect of mining activities and an exploration right and production right in respect of oil and gas activities
Minister	Minister of Minerals and Energy
MPRDA	Mineral and Petroleum Resources Development Act No. 28 of 2002, as amended
Republic/South Africa	South Africa
SARS	South African Revenue Service
State	Government of South Africa

3 Introduction

3.1 Background

South Africa's extraordinary mineral wealth has been the driving force of the economy for decades. The world's largest reserves of gold, chrome, manganese and Platinum Group Metals (PGMs) can be found in the country¹ so it is little wonder that foreign investors, since the first documented search for minerals in 1654 began², continue to explore the length and breadth of the country in order to capitalise on the opportunities presented by the abundance of natural resources available in South Africa.

Foreign direct investment (FDI) flows into South Africa between 2011 and 2012, however, decreased by 24 per cent,³ according to the United Nations Conference on Trade and Development (UNCTAD). The main reason attributed for the decline in FDI during that period has been cited by UNCTAD to be due to a foreign mining company disposing of its shares in a local subsidiary. The trend of divestment by multinationals of their South African mining assets in recent times has commentators pointing to the lack of certainty regarding mining regulation as being a point of concern for foreign investors needing assurance for their investments.⁴

In his 2013/14 Budget Speech, the Minister of Finance announced that the mining tax regime in South Africa will be assessed in a broader review of the tax system.⁵ To this end, the Davis Tax Committee (the Committee) has been established under the chair of Judge Dennis Davis. The Committee's terms of

¹ Sourced from the Pocket Guide to South Africa 2012/13. Online at: <http://www.gcis.gov.za/sites/www.gcis.gov.za/files/docs/resourcecentre/pocketguide/2012/15percent20Mineralpercent20Resources.pdf> on 26 January 2014

² Sourced from Mining Weekly. Online at: <http://www.miningweekly.com/article/van-riebeeck-and-sas-first-documented-search-for-minerals-2009-11-20> on 26 May 2013

³ Sourced from Money Web, "Foreign direct investment into SA down 24per cent", published on 27 June 2013. Online at: <http://www.moneyweb.co.za/moneyweb-economic-trends/foreign-direct-investment-into-sa-down-24> on 27 June 2013.

⁴ Sourced from Mining Weekly. Online at <http://www.miningweekly.com/article/sa-mining-laws-impact-on-foreign-investment-2011-02-11> on 26 January 2014

⁵ 2013 Budget Review, Chapter 4, Revenue Trends and tax proposals, Page 56

reference include consideration as to whether the current mining tax regime is appropriate, taking account of, *inter alia* the external challenges facing the mining sector as well as the agreement between the State, labour and business to ensure amongst other factors that the mining sector remains a competitive investment proposition.⁶

The 2013 Tax Statistics released by National Treasury paints a picture of the decline in taxes collected from mining companies over the past 5 years. In 2009, 11.1 per cent of total tax assessed was from the mining sector. By contrast, in 2012, only 4.3 per cent of total tax assessed came from the same sector.⁷

Against this backdrop, the tax consulting environment in South Africa has seen a number of multinational companies seeking tax advice, not only with regard to acquiring South African mining assets through favourable tax jurisdictions, but increasingly, with regard to the tax treatment of their investments upon future withdrawal from South Africa.

3.2 Scope and purpose of research

This research paper analyses the income tax impact for international (non-resident) companies that dispose of their shares in mining or oil and gas companies situated in South Africa.

Typically, a disposal of shares by a non-resident in a property-rich company in South Africa would attract CGT. In the case of the minerals sector, it is automatically assumed that a mining or oil and gas company is a so-called “land-rich” or “property-rich” company due to the nature of its operations. This paper seeks to test that assumption, ie do shares in a mining or oil gas company whose only asset is a mining or prospecting right or exploration or production

⁶ Sourced from The Davis Tax Committee website Online at: www.taxcom.org.za on 23 November 2013

⁷ Sourced from the 2013 Tax Statistics published jointly by National Treasury and SARS, dated 21 October 2013. Online at: <http://www.treasury.gov.za/publications/taxper cent20statistics/2013/TStatsper cent202013per cent20WEB.pdf> on 26 January 2014

right respectively qualify as an ‘interest in immovable property’ as that term is defined in the ITA for CGT purposes?

To make this determination, the term ‘immovable property’ as it is used for common –law purposes and the potential misalignment of this definition when compared to the term as it is used in the ITA must be analysed.

3.3 Structure and research questions

Each chapter in this dissertation answers questions relevant to the central question of whether a mineral right constitutes ‘immovable property’ for purposes of South African and international tax.

Chapter 4 outlines the South African tax system, specifically the components that would apply to a transaction involving a non-resident company selling its shares in a South African property-rich company.

Chapter 5 analyses the structure of paragraph 2 of the Eighth Schedule to the ITA and identifies potential issues with the meaning of the words ‘immovable property’ as it is currently contained in the ITA.

The common-law principles relating to immovable property and mineral rights is examined in Chapter 6 with the objective of distinguishing the common-law meaning of ‘immovable property’ from the meaning in the ITA.

The legal nature of a mineral right is further discussed in Chapter 7 with a view to determining how a mineral right is classified in other legislation and the ITA.

Chapter 8 provides an analysis of the immovable property article in the South African DTA network as well as the capital gains article.

The conclusion of the analyses with recommendations is set out in chapter 9.

3.4 Limitations to the study

This study does not examine the domestic law of other countries nor any other taxes (for example, Value Added Tax, Customs and Excise, etc).

In addition, this study is not concerned with the taxation of international (non-resident) individuals or trusts disposing of shares in mining or oil and gas companies. The focus of this research paper is on the taxation of a sale of shares in a mining or oil and gas company in South Africa by a non-resident company. The position of South African resident companies is likewise not considered.

4 The South African income tax system

4.1 Introduction

Since the key question posed in this paper delves into the South African income tax system, this chapter broadly outlines the South African income tax system. Since the scope of this paper is limited to non-resident companies selling shares in South African mining or oil and gas companies, the discussion on the South African tax system is limited to what would be relevant for this type of transaction.

4.2 South Africa's income tax system

South Africa has adopted a dual source or residence basis of taxation, in terms of which residents are taxed on their worldwide income. Non-residents are taxed on South African sourced income only.⁸ Both resident and non-resident companies are taxed at a corporate rate of 28 per cent.

4.2.1 Residency

Section 1 of the ITA defines a 'resident' as a person other than a natural person (eg a company) that is incorporated, established or formed in the Republic or which has its place of effective management in the Republic.⁹ Specifically excluded from the definition of 'resident' is any company that 'is deemed to be exclusively a resident of another country for purposes of the application of any agreement entered into between the governments of the Republic and that other country for the avoidance of double taxation'.¹⁰

⁸ Definition of 'gross income' in section 1 of the ITA

⁹ Paragraph (b) of the definition of 'resident' in section 1 of the ITA

¹⁰ Paragraph (A) of the definition of 'resident' in section 1 of the ITA

Accordingly, a non-resident company would be a company that is deemed, by virtue of the application of a DTA, to be exclusively resident in a foreign country.

In the event, a company is found to be resident in both South Africa and a foreign country, DTAs contain a deeming provision that renders a company to be a resident of whichever State its place of effective management is situated.

For purposes of the discussion to follow on the application of CGT, it is important to keep in mind the distinction between a resident and non-resident for tax purposes as the CGT treatment differs.

4.2.2 Source

The term ‘source’ is not defined specifically in the ITA but there are limited definitions contained in section 9 of the ITA which contains specific source rules for certain receipts and accruals that are regarded as having their source in South Africa, even if the actual source is not in South Africa.

With regard to immovable property, section 9(2)(j) of the ITA regards an amount to be from a source within South Africa if such an amount has been received by or accrued in respect of the disposal of an asset that constitutes immovable property or any interest in or right to an asset which constitutes immovable property, as contemplated in paragraph 2 of the Eighth Schedule, and that property is situated in South Africa.¹¹

Thus, section 9(2)(j) of the ITA specifically states that the source of income attributable to immovable property, or any interest or right therein, is where the immovable property is *located*.

¹¹ Section 9(2)(j) of the ITA

The specific source rules contained in section 9(2)(j) of the ITA is in line with the position adopted by South African courts, ie that the source of immovable property is where it is situated.¹²

To the extent, therefore, that the disposal of shares in a mining company located in South Africa constitutes immovable property or any interest or right therein, any amount received in respect of the disposal of such shares will be regarded as being from a source in South Africa. Accordingly, such income would be subject to South African income tax in the hands of the non-resident company at a rate of 28 per cent. If the shares are held as capital assets by the non-resident company, the proceeds of the sale of shares would be subject to CGT.

4.2.3 Capital versus revenue

Before discussing the application of CGT, it would first be important to point out the difference between the revenue treatment of a disposal of shares and the capital treatment of a disposal of shares as it relates to the later analyses.

The income tax treatment of a transaction that is capital in nature differs significantly to a transaction that is revenue in nature. With regard to the sale of shares, there is a plethora of case law dealing with the issue of whether a sale of shares is capital or revenue in nature. Prior to the introduction of CGT in the ITA, transactions of a capital nature were excluded from gross income. Capital gains now form part of taxable income; however, it is still advantageous for a transaction to be classified as capital in nature than revenue given that CGT rate for companies is 66.6 per cent.

4.2.4 CGT

Paragraph 2 of the Eighth Schedule to the ITA defines the scope of the CGT legislation and prescribes who is subject to CGT as well as which assets of such persons are subject to CGT.¹³

¹² *Rhodesia Metals Ltd (in Liquidation) v Commissioner of Taxes* (1938) AD

An 'asset' is defined in paragraph 1 of the Eighth Schedule to the ITA and includes *"property of whatever nature, whether movable or immovable, corporeal or incorporeal, excluding any currency, but including any coin made mainly from gold or platinum and a right or interest of whatever nature to or in such property"*.

A 'disposal' is defined in paragraph 11 of the Eighth Schedule to the ITA as *"any event, act, forbearance or operation of law which results in the creation, variation, transfer or extinction of an asset"* and includes *"the sale, donation, expropriation, conversion, grant, cession, exchange or any other alienation or transfer of ownership of an asset."* Specific events have been excluded from the definition of a disposal event such as the issue or cancellation of shares in a company.

In the case of a resident,¹⁴ paragraph 2(1)(a) of the Eighth Schedule to the ITA provides that the disposal of any asset would be subject to CGT.

Paragraph 2(1)(b) of the Eighth Schedule to the ITA provides that the Eighth Schedule will apply to the disposal of the following assets held by a non-resident:

- (i) immovable property situated in the Republic held by that person or any interest or right of whatever nature of that person to or in immovable property situated in the Republic; or
- (ii) any asset which is attributable to a permanent establishment of that person in the Republic.

Whereas the resident is subject to CGT on any asset whether disposed of inside or outside of South Africa, a non-resident may be subject to CGT in South Africa not only in respect of the sale of land or property attached to land which is situated in South Africa (ie immovable property), but also in respect of the

¹³ Comprehensive Guide to Capital Gains Tax (Issue 4), released by SARS in December 2011, page 45 at para 4.2

¹⁴ Defined in section 1 of the ITA

disposal of interests or real rights relating to immovable property such as registered leases, usufructs, mineral rights, etc.

The non-resident will not be taxed on the disposal of any other asset unless it is attributable to a permanent establishment (PE). Thus, should the non-resident seller not have a permanent establishment in South Africa, it is trite that paragraph 2(1)(b)(ii) above would not apply.

‘Immovable property’ is not a defined term in the ITA, however, the meaning of ‘interest in immovable property’ is provided in paragraph 2(2) of the ITA.

Paragraph 2(2) states as follows:

“For purposes of subparagraph (1)(b)(i), an interest in immovable property situated in the Republic includes any equity shares held by a person in a company or ownership or the right to ownership of a person in any other entity or a vested interest of a person in any assets of any trust, if –

(a) 80 per cent or more of the market value of those equity shares, ownership or right to ownership or vested interest, as the case may be, at the time of disposal thereof is attributable to directly or indirectly to immovable property held otherwise than as trading stock; and

(b) In the case of a company or other entity, that person (whether alone or together with any connected person in relation to that person), directly or indirectly, holds at least 20 per cent of the equity shares in that company or ownership or right to ownership of that other entity.”

It is important to remember that CGT is not a separate tax from income tax. Instead, a taxpayer is required to include its ‘net capital gain’¹⁵ for the year of assessment in its taxable income, at the relevant inclusion rate. In the case of a

¹⁵ Defined in paragraph 8 of the Eighth Schedule to the ITA

company, the inclusion rate is 66.6 per cent. Hence, the seller will be subject to CGT in South Africa at an effective rate of 18.6 per cent on the net capital gains realised on the disposal of any asset (in the case of a resident) or immovable property or any interest or right therein (in the case of a non-resident) during any year of assessment.

Should a net capital loss be realised in any year of assessment, such loss may not be set-off against other taxable income and is carried forward to be set-off against future capital gains.

A person's 'capital gain'¹⁶ or 'capital loss'¹⁷ for a year of assessment, in respect of the disposal of an asset is defined, in essence, as the difference between the 'proceeds'¹⁸ received or accrued in respect of the disposal or deemed disposal of an asset and the 'base cost'¹⁹ of that asset.

The "proceeds" from the disposal of an asset include, *inter alia*, the amount²⁰ received by or accrued to, or which is treated as having been received by, or accrued to or in favour of the person disposing of that asset in respect of that disposal.²¹

The amount received by or accrued as proceeds will be reduced by, *inter alia*; any amount that must be included in the gross income of that person or that must be taken into account when determining the taxable income of that person before the inclusion of any taxable capital gain.²² For example, any depreciation allowances recovered or recouped on disposal of an asset would have been included in the gross income of a person and should, consequently, reduce the proceeds received on disposal of that asset.

¹⁶ Paragraph 3 of the Eighth Schedule to the ITA

¹⁷ Paragraph 4 of the Eighth Schedule to the ITA

¹⁸ Defined in paragraph 35 of the Eighth Schedule to the ITA

¹⁹ Defined in paragraph 20 of the Eighth Schedule to the ITA

²⁰ South African courts have held that the word 'amount' must be given a wide meaning and would include 'not only money, but the value of every form of property earned by the taxpayer, whether corporeal or incorporeal, which has a money value'.

²¹ Paragraph 35(1) of the Eighth Schedule to the ITA

²² Paragraph 35(3) of the Eighth Schedule to the ITA

In the case of the disposal of immovable property or any interest or right therein by a non-resident, the proceeds will be an amount equal to the amount or amounts received by or accruing to the non-resident in exchange for the transfer or sale of such immovable property or interest or right therein.

Furthermore, where the parties to the transaction are ‘connected persons’,²³ the person disposing of the asset must be treated, for CGT purposes, as having disposed of that asset at market value,²⁴ and the person acquiring the asset is treated as having acquired the asset also for an amount equal to the same market value.

4.2.5 Withholding tax on immovable property

In the case of non-resident sellers of South African immovable property, a withholding tax on the gross amount paid to them is imposed in terms of section 35A of the ITA. The withholding tax is equal to:

- 5 per cent, where the non-resident is natural person;
- 7.5 per cent, where the non-resident is a company; and
- 10 per cent, where the non-resident is a trust.

Since the scope of my analyses is limited to transactions involving non-resident companies, only the 7.5 per cent withholding tax rate is relevant hereon after.

Although, at the time, non-residents were subject to income tax (including CGT) on a source basis, the revenue authorities were not able to properly administer taxation on the sourced income of non-residents attributed to the disposal of immovable property in South Africa.

The Explanatory Memorandum to the 2004 RLAA explains the introduction of the withholding tax as follows:

²³ Defined in section 1 of the ITA

²⁴ Paragraph 38(1)(a) of the Eighth Schedule to the ITA

“The current system of taxing locally sourced capital gains generated by non-residents is consistent with international best practice and is well-recognised by international income tax treaties. However, this system of source taxation lacks one essential element – proper administrative enforcement through withholding. Many countries that tax capital gains generated by non-residents impose a special withholding regime when the sale involves immovable property. This withholding regime is often critical because the non-resident’s connection to the source country is often tenuous, making enforcement impossible once the immovable property is sold. Enforcement is much easier in terms of the purchaser because the purchaser is the party holding the local immovable property upon completion of the transaction. As a side matter, this form of withholding is not internationally utilised in the case of capital gains generated by non-residents when those gains are associated with a local permanent establishment. No withholding is required in these instances because the non-resident’s practical connection to the source country is much more extensive.”

From this extract, it is clear that the reason for introducing the withholding tax was pure administrative convenience, ie the purchaser now had the obligation to collect an amount for which the non-resident would themselves be liable for in terms of normal tax. It must be noted that the obligation on the purchaser to withhold the tax is irrespective of whether the purchaser is resident in South Africa or not and also irrespective of whether the amount of the purchase price is capital or revenue in nature.

Section 35A therefore provides that where a non-resident company disposes of an asset to a person that is either a South African resident or a non-South

African resident, the person purchasing the asset is obligated to withhold an amount of 7.5 per cent from the purchase price.²⁵

Importantly, however, for section 35A to be applicable, the non-resident must have disposed of “immovable property” in South Africa. In terms of section 35A(15) of the ITA, immovable property is defined to mean ‘immovable property’ as contemplated in paragraphs 2(1)(b)(i) and (2) of the Eighth Schedule in the ITA.

With regard to the administration of the withholding tax, the tax withheld must be paid by the purchaser to the South African Revenue Service (SARS) within fourteen days after the date of withholding (where the purchaser is a resident) and twenty eight days (where the purchaser is non-resident).²⁶ A return has to be submitted by the purchaser making the payment.²⁷ Penalties will be payable by the purchaser should the relevant amount not be paid to SARS within the time prescribed.

The seller may, however, apply to SARS for a directive to the effect that no amount or a reduced amount must be withheld. SARS, in turn, ‘solely having regard’ to the following factors, may determine whether to grant the directive sought by the seller:

- Any security furnished for the payment of tax due on disposal of the immovable property;
- The extent of the seller’s assets in South Africa;
- Whether the seller is subject to tax in respect of the disposal of the immovable property; and
- Whether the seller’s actual tax liability in respect of the disposal of the immovable property is less than the amount required to be withheld.²⁸

Unlike a withholding tax on royalties or similar payments to non-residents under section 35 of the ITA, this is not a final withholding tax in that the amounts

²⁵ Section 35A(1)(b) of the ITA

²⁶ Section 35A(4) of the ITA

²⁷ Section 35A(6) of the ITA

²⁸ Section 35A(2) of the ITA

withheld act as a credit against the final normal tax liability for the year of assessment in which the property is disposed of.²⁹

The withholding tax provisions of Section 35A are not absolute. They do not apply:³⁰

- if the amounts payable by the purchaser in aggregate do not exceed R2 million, thereby limiting the withholding obligation to high-value properties. If the purchase consideration exceeds R2 million, the withholding requirements apply to the total consideration without regard to the R2 million exemption; and
- to a deposit payable by the purchaser for the purpose of securing the disposal of immovable property until the agreement has been entered into. Once entered into, any withholding tax required to have been withheld from the deposit must be withheld from the first payment made by the purchaser other than the deposit.

²⁹ Section 35A(3) of the ITA

³⁰ Section 35A(14) of the ITA

5 Analysis of ‘immovable property’ as used in the ITA

As highlighted in 4.2.4, whereas CGT may be levied on the disposal of any asset of a resident, its application with respect to non-residents is limited to the disposal of immovable property or any interest or right therein.

5.1.1 Lack of definition in the ITA

‘Immovable property’ on its own is not defined generally in the ITA or specifically in the Eighth Schedule. Instead, paragraph 2(2) of the Eighth Schedule to the ITA states that, for purposes of paragraph 2(1)(b)(i), ‘an interest in immovable property’ includes any equity shares held by a non-resident person if 80 per cent or more of the market value of those equity shares, as at the time of the disposal thereof by the non-resident, ‘is attributable directly or indirectly to immovable property’ situated in South Africa and which is held as a capital asset (i.e. otherwise than as trading stock); and such non-resident person directly or indirectly holds at least 20 per cent of those equity shares.

Strangely enough, the words ‘immovable property’ occurs at least four times in paragraph 2 of the Eighth Schedule, yet the legislators did not feel the need to include a definition either specifically for the Eighth Schedule or more broadly in the ITA.

As has been explained in the previous chapter, the withholding tax in terms of section 35A of the ITA only applies where a non-resident sells ‘immovable property’ situated in South Africa. Section 35A(14) defines ‘immovable property’ to mean “*immovable property contemplated in paragraph 2(1)(b)(i) and (2) of the Eighth Schedule.*”

Importantly, it is not ‘immovable property’ that is defined in paragraph 2(1)(b)(i) and (2) of the Eighth Schedule but ‘*an interest in immovable property*’ that is defined in paragraph 2(2) for purposes of interpreting those words in paragraph 2(1)(b)(i) of the Eighth Schedule.

According to Haupt,³¹ if a word is not defined or is incompletely defined in the ITA one needs to look at the Interpretation Act for a definition. If the word is not defined in the Interpretation Act, the word or phrase must be interpreted according to the ordinary meaning in the dictionary. Haupt goes on to say:

“Full effect must be given to all the words used in a provision, No word must be assumed to be superfluous. Where a provision does not make sense the courts have had to (of necessity) imply words or meanings... Mbha J, in Tax Case No. 12860 ... said: “It is accepted generally that the meaning of the words in a statute is derived from the common-law. The basic rule of interpretation is that the meaning must, unless it would result in an absurdity, be taken to be the ordinary meaning of the word which can now be found in a dictionary of established authority.””

Following Haupt’s recommendation where a word is not defined in the ITA, a review of the Interpretation Act,³² indicates no definition for ‘immovable property’ either. The ordinary dictionary meaning of ‘immovable’ indicates it means “not able to be moved” or “consisting of land, buildings, or other permanent items”.³³ The dictionary meaning of ‘property’ is “a thing or things belonging to someone” or “a building or buildings and the land belonging to it or them”.³⁴ Thus, the ordinary meaning of the words ‘immovable’ and ‘property’ as defined in the dictionary leans towards referring to property in a corporeal sense and does not envisage rights or interests in property (i.e. incorporeal property) to be immovable property *per se*.

³¹ Phillip Haupt, Notes on South African Income Tax, 2013, page 12

³² No. 33 of 1957

³³ Sourced from Oxford Dictionary. Online at <http://www.oxforddictionaries.com/definition/english/immovable> on 16 February 2014

³⁴ Sourced from Oxford Dictionary. Online at <http://www.oxforddictionaries.com/definition/english/immovable> on 16 February 2014

5.1.2 Structure of paragraph 2 of the Eighth Schedule

Having established that there is no definition, specific or otherwise, of ‘immovable property’ in the ITA and that the ordinary meaning of the words refers to property in a corporeal sense, it is important to analyse paragraph 2 of the Eighth Schedule in more detail.

In paragraph 2(1)(b)(i), the words ‘immovable property’ are used twice in two phrases couched as alternatives – once in the phrase “*immovable property situated in the Republic*” and then again, after being linked by the conjunction “*or*”, used in the second phrase “*any right or interest of whatever nature ... to or in immovable property*”.

Analysing paragraph 2(1)(b)(i), it may be concluded using the normal tenets of interpretation of statutes that the words ‘immovable property’ as used in the first instance refers to property in the normal meaning of the word (i.e. corporeal property) and not to any interest or right in that property (i.e. not to incorporeal property) for purposes of section 35A of the ITA.

This conclusion may be drawn since where the second phrase in the sub-paragraph quoted above refers to “*any interest or right ... to or in immovable property...*” it clearly refers to incorporeal property (i.e. a right to property is incorporeal). Thus, where the words ‘immovable property’ is used in the first phrase of the sub-paragraph quoted above, it cannot also be ascribed to the same meaning as “*any interest or right ... to or in immovable property*”. If this was the case, the subsequent reference to “*any interest or right ... to or in immovable property*” would be repetition or superfluous. In addition, to refer to the same concept twice in one sentence yet in the alternative (linked by the word “or”) makes no grammatical sense (for instance, “an apple or an apple” is an absurd sentence construction).

If the argument is to be followed that the words ‘immovable property’ in paragraph 2(1)(b)(i) of the Eighth Schedule to the Act refer only to corporeal

property (as opposed to also including incorporeal rights in respect of immovable property), then where the same words are used twice in paragraph 2(1)(b)(i), it should have the same meaning, namely corporeal immovable property (i.e. to refer to land and fixtures to land).

It could then be argued that the 80 per cent rule, in terms of paragraph 2(2)(a) of the Eighth Schedule, should only apply with regards to immovable property (i.e. corporeal), and not ‘a right or interest ... in immovable property’ (i.e. incorporeal) since 80 per cent of the market value of the shares being disposed of must be attributable to immovable property (i.e. corporeal). Accordingly, the value of mineral rights would not be included in calculating the 80 per cent value of the share, as these rights are incorporeal in nature and would not be regarded as ‘immovable property’ as provided in paragraph 2(2)(a) of the Eighth Schedule.

The Comprehensive Guide to Capital Gains Tax (Issue 4) published by SARS (the CGT guide), defines immovable property according to LAWSA as “*things which cannot be moved from one place to another without damage or change of form*”.³⁵ Examples of immovable property cited in the CGT guide include real rights over immovable property.³⁶

Paragraph 4.1.2.3 of the CGT guide argues that “new order rights” (which would include mining, prospecting, exploration or production rights issued in terms of the MPRDA) share characteristics of other types of immovable property including that (i) they are limited real rights, (ii) they are granted in respect of the mineral and the related land implying a close causal connection with the mineral and the land, (iii) the subject matter of the right can only be removed by causing damage to the land because the land has to be excavated to extract the mineral and (iv) those rights are not dissimilar to a long-term lease, a

³⁵ Page 37 of the CGT guide

³⁶ Same as above

usufruct or a servitude, all of which are rights of enjoyment of immovable property.

Interestingly, paragraphs 4.1.2.1 and 4.2.2.2 of the CGT guide deals with corporeal and incorporeal property respectively. The distinction between corporeal and incorporeal property as discussed in the CGT guide can be summarized as follows – corporeal property such as land and buildings have the capacity to be handled or touched whereas incorporeal things are imaginary concepts that cannot be seen or touched such as personal or real rights.³⁷

It is worthwhile noting that paragraph 4.1.2.3 of the CGT guide is a sub-paragraph of paragraph 4.1.2 of the CGT guide which deals with the definition of the word ‘asset’ as defined in the Eighth Schedule.

Importantly, the words ‘immovable property’ is not used in the definition of the term ‘asset’, as defined in the Eighth Schedule. The words used in paragraph (a) of the definition of “asset” in paragraph 1 of the Eighth Schedule are *“...property of whatever nature, whether movable or immovable, corporeal or incorporeal...”* Both corporeal and incorporeal are specifically included into the definition. Thus, where reference is made to property which is immovable, it is not necessary to include incorporeal property in that concept (since incorporeal property is specifically included in the definition of ‘asset’ in addition to the reference to property that is immovable). In other words the concepts of immovable and incorporeal are divisible for purposes of the Eighth Schedule.

5.1.3 Effect on CGT if mineral right is not immovable property

To be able to determine whether the provisions of paragraph 2(2) of the Eighth Schedule apply to a non-resident disposing of a share in a company that holds a mineral right, it is necessary to consider the meaning of paragraph 2(2). It is clear that the phrase ‘interest in immovable property’ in paragraph 2(1)(b)(i) is

³⁷ Page 36 of the CGT guide

given a specific meaning in the introductory passage to paragraph 2(2) of the Eighth Schedule.

In the introductory passage, it is provided that, for purposes of sub-paragraph 2(1)(b)(i) ‘an interest in immovable property’ includes *“any equity shares held by a person in a company ... if 80 per cent or more of the market value of those equity shares ... at the time of disposal thereof is attributable directly or indirectly to immovable property held otherwise than as trading stock.”*

In this regard, the 80 per cent of the market value of the equity shares need to be attributable to ‘immovable property’ only and not to ‘any interest or right of whatever nature to or in immovable property’. Thus, it is possible, in the absence of a definition of ‘immovable property’ in the ITA, that a disposal of shares in a mineral company would not meet the 80 per cent rule of paragraph 2(2)(a), as a consequence of which no CGT would apply to such a transaction. For purposes of completeness, it should be clear that the words ‘directly or indirectly’ in paragraph 2(2)(a) indicate the intention of the legislature to include, not only the value of immovable property perhaps owned by the non-resident, but also immovable property owned by any other company in which the non-resident owns shares or has an interest. This view is supported by the CGT Guide.³⁸

5.1.4 Effect on section 35A if mineral right is not immovable property

To iterate, section 35A(15) of the ITA states that ‘immovable property’ for purposes of section 35A *“means immovable property as contemplated in paragraph 2(1)(b)(i) and 2 of the Eighth Schedule.”* (**emphasis added**). In terms of the Supreme Court of Appeal decision in *Rogut v Rogut*,³⁹ the word “means” *“indicates that what follows is in their nature of a precise definition. Obviously it is not as expansive as “includes”.*” Thus, if the provisions of

³⁸ Page 47 of the CGT guide shows an example of an indirect shareholding in a land rich company

³⁹ 1982(3) SA 928 (AD) at 937G-H.

paragraph 2(1)(b)(i) and 2 of the Eighth Schedule do not apply to the transaction envisaged, the provisions of section 35A should also not apply.

Section 35A(3) provides that the 7.5 per cent withholding tax “*is an advance*” in respect of the seller’s “*liability for normal tax*.” The fact that the 7.5 per cent withholding tax “*is an advance*” in respect of the seller’s “*liability for normal tax*” means that the seller must in fact have a “*liability for normal tax*”. It could be said that such “*liability for normal tax*” does *not* arise because paragraph 2 of the Eighth Schedule does *not* apply to the disposal of shares where the shares are not attributable to immovable property.

6 Mineral rights in South Africa

6.1 Introduction

Given the gravitas of the preliminary conclusions set out above in **Error! eference source not found.** and 5.1.4, it would be important to consider the meaning of the words ‘immovable property’ in terms of common-law principles. Should there be a dispute in this regard between a taxpayer and SARS over seemingly insufficient clarity in the ITA, the interpretation of not only statutory legislation is important but also the common-law principles set out by earlier court cases.

This chapter looks at the common-law principles related to immovable property and how the history of mineral rights in South Africa shaped those principles. The objective of this chapter is to review the common-law meaning of ‘immovable property’ and distinguish this from the meaning of those words ascribed by the previous chapter.

6.2 Historical background of mineral rights in South Africa

Africa is exceptionally rich in minerals and South Africa, in particular, has extensive deposits of important mineral ore.⁴⁰ Over the years, regional legislation was adopted to regulate the exploration and mining of particular categories of minerals. In 1991, the Minerals Act No.50 of 1991, as amended (the 1991 Minerals Act) was enacted to consolidate the various regional laws into a single mineral regime for South Africa.⁴¹

⁴⁰ Extracted from <http://www.physchem.co.za/OB11-sys/mining.htm#sa> on 25 May 2013

⁴¹ Johan D van der Vyver, “Nationalisation of mineral rights in South Africa”, De Jure, 45 Vol 1 2012 pp 126-143

6.2.1 Common-law principles relating to immovable property

South African present day common-law is drawn primarily from Roman-Dutch and, to a lesser extent, English law, which have been combined and adapted by the courts so as to meet what the courts perceived as the country's own evolving needs⁴². In general, the South African law of property has developed out of these three main components of Roman, Dutch and English law.

The most important classification of property is the division between movables and immovables.⁴³ Stated generally, immovable property is land and those things that are attached to land either naturally or by artificial means in such a manner that it cannot be detached from the land without being damaged and without losing its identity.⁴⁴

It becomes more complex to define immovable property generally when one considers whether incorporeal things constitute immovable property. If it does, it must further be determined which of those incorporeal things qualify as immovable property. South African early case law evidences that this question was as relevant as it is now.

In *Ex Parte Master of the Supreme Court*⁴⁵, the question was whether a deed of lease for 99 years constituted 'immovable property' as that term was used in the Administration of Estates Proclamation of 1902. Section 108 of the proclamation allowed the Master to invest monies to the Guardian's Fund on mortgage of immovable property. The Court, noting that the term was not defined, held that it must be assumed that the legislature used the expression 'immovable property' in its ordinary legal sense. After examining the common-law writers such as Van Der Keesel, Voet and Mattheus, the Court concluded that the Roman law recognised the division of incorporeal rights between movable or immovable wherever possible. The Court considered that such a

⁴² Du Bois, F (2007)

⁴³ van der Merwe, C.G. (2007)

⁴⁴ See Joubert (ed) (2007)

⁴⁵ *Ex Parte Master of the Supreme Court* 1906 TS 563 at 565-566

division of incorporeal property does not only seem to be the general rule in the Roman Dutch law, but had also been adopted by the legislature in the Transvaal where it clearly dealt with incorporeal property as immovable property in several statutes. As a consequence, the Court ruled that a lease over fixed property for a period of 99 years constituted immovable property for purposes of the Administration of Estates Proclamation. This view has since been confirmed by other authors on the law of property⁴⁶.

A distinction should be drawn between real and personal rights where real rights have corporeal property as its object whilst performance by another person is the object of a personal right. Following this distinction, it could be said that a personal right will never qualify as immovable property whilst real rights can be divided into real rights pertaining to immovable property which are then regarded as immovable and real rights pertaining to movable things which are then regarded as movable incorporeal property.

This logical approach, however, is not consistently applied since, as has been shown in the *Ex Parte Master* case, long term leases are recognised as immovable property whilst short term leases (which are real rights, albeit limited, in respect of immovable properties) are generally not recognised as immovable property. This distinction was probably brought about by the definition of immovable property in section 102 of the Deeds Registries Act.⁴⁷ The Deeds Registries Act defines ‘immovable property’ to include, *inter alia* –

*“Any registered lease of land which, when entered into, was for a period of **not less than ten years** or for the **natural life of the lessee** or any other person mentioned in the lease, or which is renewable from time to time at the will of the lessee indefinitely or for the periods which together with the first period amount in all to **not less than ten years (emphasis added)**”*

⁴⁶ See LAWSA – para 225

⁴⁷ No. 47 of 1937

Thus, earlier case law suggests that where the words ‘immovable property’ are not defined, the Courts will look to other legislation where the term is defined (more than one statute if need be) to determine the legislator’s intention.

6.2.2 Common-law principles relating to mineral rights

Roman law regarded minerals as fruits of the soil and did not allow separate mineral rights with regard to the soil.⁴⁸ English law on the other hand recognised separate ownership of strata of the soil under the surface as possible.⁴⁹

Given the massive capital investment mining houses had to outlay (and still do today) for mining projects, it was necessary to provide such mining companies with distinct real rights as security.⁵⁰ Thus, an entire structure of mineral and mining law had to be evolved in South Africa by the courts and various legislatures. The need for such development arose from a lack of such laws in the Roman-Dutch system (which can be linked to the lack of mining activities in the Netherlands in the early 16th to 18th century).⁵¹ The South African practice, which did not recognise the English notion that horizontal layers of land beneath the soil could belong to the different owners, in the view of the exclusive nature of ownership therefore sought to structure mineral rights as distinct limited real rights that could exist alongside ownership on the same land.⁵²

In *Trojan Exploration Co (Pty) Ltd v Rustenburg Platinum Mines Ltd & others* 1996 (4) SA 499 (A), two companies had mineral rights and mining title in respect of precious metals whilst another two companies held all the other mineral rights and the right to prospect for all other minerals. The Court was faced with deciding on the conflict between the two rights holders.

⁴⁸ Du Bois, F (2007), Page 617

⁴⁹ Supreme Court of Appeal (SCA) case of *Minister of Minerals and Energy v Agri SA (CALS amicus curiae)* (458/11)[2012] ZASCA 93 (31 May 2012) (hereafter referred to as the Agri SCA case) at para 32

⁵⁰ Du Bois, F (2007), Page 618

⁵¹ *Trojan Exploration Co (Pty) Ltd v Rustenburg Platinum Mines Ltd & others* 1996 (4) SA 499 (A)

⁵² Du Bois, F (2007), Page 618

With regard to the nature of the rights to minerals which had been separated from the ownership of the land, the Court held that such rights were real rights. In the case of irreconcilable conflict between the exercise of these rights and the interests of the landowner, the latter were subordinated. The minerals continued to be the property of the landowner for as long as they remained in the ground; it was only when the holder of the right to the minerals severed them that they became movables owned by him. Those are the main established common-law principles relating to mineral rights that were found to be relevant in the judgement.⁵³

The concept of mineral rights is founded on the right to mine.⁵⁴ In the Agri SA SCA case, Wallis J questioned whether the right to mine actually had its source in the common-law as the plaintiff, Agri SA, sought to claim in that case.

Wallis J highlighted in the Agri SA SCA case that the common-law principle is that the rights of the owner of immovable property extend up to the heavens and down to the centre of the earth.⁵⁵ This is usually expressed in the maxim *cuius est solum eius usque ad caelum et ad inferos* (usually abbreviated in academic writing as the *cuius est solum* principle). Thus, in general, the owners of property are free to do with the land what they wish to do. This, Wallis J, argues is the foundation of the view that as a matter of common-law, the right to mine vests in the owner of the land.⁵⁶

Whilst it has been a long-standing principle to regard mineral rights as ‘common-law’ rights⁵⁷, and this characterisation was certainly adopted by the trial court leading up to the Agri SA SCA case, Wallis J sought to establish that what has come to be referred to as common-law mineral rights, in both the judgement of the trial court and academic writings, in fact originate largely from statutory law governing the right to mine and legislation that permitted personal

⁵³ At 509A – 510A

⁵⁴ Agri SA SCA case (*supra*) at para 28

⁵⁵ Agri SA SCA case (*supra*) at para 32

⁵⁶ Agri SA SCA case (*supra*) at para 33

⁵⁷ *Trojan Exploration Co (supra)*

rights, obtained under contracts, to be registered as rights separate from the ownership of the land to which those rights related.⁵⁸ Whilst the legal issue of expropriation formed the basis of the judgements in the trial court, SCA and Constitutional Court (Concourt) and expropriation itself bears no relevance to the outcome of this paper, the historical analyses of mineral rights in South Africa provided in the trial court but more especially the SCA case bears some consideration and it is thus worthwhile to consider the judgements of both Du Plessis J in the trial court as well as Wallis J in the SCA case. Chief Justice Mogoeng Mogoeng's Concourt judgement will also be considered to the extent it can be distinguished from the findings of the SCA case.

6.2.3 Facts of the Agri SA cases

The facts of the case were a company, namely Sebenza Mining (Pty) Ltd (Sebenza) held coal rights on certain farms situated in Mpumalanga. It did not have any prospecting permit or mining authorisation under the 1991 Minerals Act. In April 2004, the members resolved to wind it up. In May 2004, the MPRDA commenced. The rights were sold to a third party for R750 000. Lawyers for both seller and purchaser gave opinions that the MPRDA had caused the rights to cease to exist rendering the sale void. In 2006, Sebenza's liquidators applied to the DMR for compensation claiming the State had expropriated the rights in terms of item 12(1) of Schedule II to the MPRDA. The claim was rejected by the DMR. On 10 October 2006, Sebenza ceded its claim to Agri SA, which acquired it for R250 000, for the purpose of initiating legal proceedings, having identified the case as being a suitable test case.

6.2.4 Issues

The issues before the trial court were whether the MPRDA deprived Sebenza of its coal rights. If so, it needed to be determined if Sebenza had been

⁵⁸ Agri SA SCA case (*supra*) at para 68

expropriated of its coal rights and, if so, whether Sebenza (and thus Agri SA as cessionary) was entitled to compensation?

6.2.5 Trial court judgement

On the first issue of deprivation, the trial court held that the commencement of the MPRDA had deprived Sebenza of its rights on the basis that the common-law right included the entitlement to go onto the property, to search for the mineral and sever it and carry it away. The MPRDA, the trial court held, did not recognise this common-law right and had as such, deprived Sebenza of its coal rights. On the second issue of expropriation, the court held that Item 8 of Schedule 3 of the MPRDA gave the holder of an unused old-order right *only* the right to *apply* for a prospecting or mining right defined in section 5 of the MPRDA. In effect, this constituted an expropriation. Accordingly, the court concluded that the plaintiff, Agri SA, had a right to compensation to R750 000.

6.2.6 Different conclusion reached by the SCA

In a unanimous judgement delivered in May 2012, the SCA upheld an appeal by the Minister of Minerals and Energy (the Minister). The Court had to decide on Agri SA's contention that a blanket expropriation of mineral rights had been triggered when the MPRDA commenced. It is important to analyse the reasons for the different conclusions reached by the SCA in relation to the trial court.

The principle that mineral rights are regarded as common-law rights was rejected by Wallis J in the Agri SA SCA case. He determined that such a characterisation was incorrect and that it was merely '*a convenient shorthand terminology....erroneously construed as identifying the source of minerals rights.*'⁵⁹

⁵⁹ Agri SA SCA case (*supra*) at para 82

Wallis J, in delving into the history of mineral rights (the detail of which one is encouraged to read from paragraphs 29 to 80 of the judgement as it provides a detailed historical analysis) endeavours to show that the State always asserted that the right to mine is vested in the State and that the State either exercises or allocates that right. The MPRDA is to be seen as another piece of legislation in many, over the years, that affirms that the right to mine is vested in the State. Thus, for purposes of the Agri SA SCA case, the Court found that the fundamental right to mine had not been expropriated from the holders of mineral rights by the commencement of the MPRDA. This conclusion was supported by the fact that the MPRDA afforded security of tenure through transitional provisions contained in the MPRDA. However, the Court did emphasis that there exists the possibility of an argument that a right had been expropriated by the MPRDA in specific factual circumstances but held that the contention advanced by Agri SA that there had been a general expropriation of mineral rights was unfounded. This was so whether one considered mineral rights generally or only unused mineral rights.

The nature of prospecting or mining rights was explored further in the Agri SA SCA case, wherein Wallis J noted that ‘mineral rights’ under earlier legislation “were held either by the owner of land or, where they had been separated from the land in respect of which the rights were exercised, the holder of a separate right,” and that those rights can for present purposes be referred to generally as mineral right and the beneficiaries of the rights as holders of mineral rights.⁶⁰ Some judgments refer more succinctly to the “right to mine”, which has similarly come to denote “the right to prospect and mine for minerals and extract and dispose of them.”⁶¹

⁶⁰ Agri SA SCA case at para 4

⁶¹ Ibid

Other commentators⁶² go on to describe the concept of ‘mineral rights’ as follows with reference to the Agri SA SCA case:

“It is a real right, sometimes referred to as quasi-servitude⁶³ and must therefore be distinguished from the *ius in re sua* (ownership) of the minerals as such. The granting of a right to explore and mine minerals could be obtained in various ways. The owner of the land could apply for a certificate of rights to minerals in respect of the land of which he or she was the owner. Mineral rights could be ceded to a third person through the registration of a notarial deed registered against the title deed of the land, or a certificate could be issued to the third person authorising that third person to explore and to mine the minerals. The right granted to the third person could apply in general or only in respect of a particular category of minerals. It was not uncommon in South Africa for landowners to separate their ownership of the land from mineral rights, for example by retaining the mineral rights relating to the land upon the sale of the land.⁶⁴

Where mineral rights vested in a person other than the landowner, that person was “entitled to go upon the property to which they relate to search for minerals, and, if he (the holder) finds any, to sever them and carry them away.”⁶⁵ Upon separation of the minerals from the land, they became distinct legal objects, and the person with mineral rights would acquire ownership of the minerals separated from the land.

The person who has acquired mineral rights was also entitled to transfer the right to search for and to mine the minerals to a third person. This could be done through (a) a prospecting contract, or (b) a mineral lease agreement. The mineral lease agreement afforded the right for a limited period only. The repository of

⁶² Johan D van der Vyver, “Nationalisation of mineral rights in South Africa”, *De Jure*, 45 Vol 1 2012 pp 126-143

⁶³ *Ibid*

⁶⁴ *Ibid*

⁶⁵ *Ibid*

mineral rights could claim compensation from the third person to whom he or she had transferred the prospecting rights.

One must therefore distinguish between (a) the ownership of minerals and (b) mineral rights in the sense of searching for and extracting minerals from the land. Ownership of minerals that formed part of the land vested in the landowner, and following their extraction from the land vested in the person with mineral rights, which could be the owner of the land or a person other than the land owner.”

6.2.7 Concourt decision

The Concourt found against Agri SA but for different reasons from the SCA that expropriation had not come about with the enactment of the MPRDA. With regard to the nature of the affected rights, the Concourt majority disagreed with the SCA that mineral rights did not constitute property,⁶⁶ observing that under the previous regime, only the owner of mineral rights could apply for a licence, while it could choose whether to exploit its underlying rights.

6.2.8 Other case law and commentary

The case of *Ex Parte Master of the Supreme Court*⁶⁷ (discussed above under 6.2.1 is an example of a lease of mineral rights being recognised as a registerable real right. In this case, the Court, in inquiring what the common-law meaning of the term “immovable property” is, considered whether the classification of things into immovable and movable property relates only to corporeal property. In this regard, the Court held that there are circumstances, such as insolvency, under which very important results might follow in respect of the classification of an incorporeal right as movable or immovable. The Court also considered that the 99 year leases were not merely registered against the

⁶⁶ Agri SA Concourt case at para 33

⁶⁷ 1906 (*supra*)

title deeds, but they were specially transferred by deed in the Register of Mining Rights. The court furthermore considered that the transfer of such leases is liable to transfer duty. The Court, therefore, concluded that the lease constituted 'immovable property' by virtue of being a registerable real right.

Other examples can be found in *Government of the Republic of South Africa v Oceana Development Investment Trust Plc.*⁶⁸ In this case, it was stated that

*“...whatever the precise juristic nature of mineral rights may be, there is also no doubt that that they are incorporeal rights relating to immovable property and hence **must be regarded themselves as immovable incorporeal**”.*(*emphasis added*)

Thus, mineral rights have been recognised as immovable property in the sense of an incorporeal right to the land to which the mineral relates.

For example, a common-law prospecting contract coupled with an option either to purchase or lease the mineral rights in respect of which the prospecting contract was granted, constitutes a limited real right and is registerable in terms of the Deeds Registries Act. However, should the prospecting contract not come with an option to lease or purchase the mineral rights, there is authority in the *Vansa Vanadium* case⁶⁹ that such a contract would not constitute a real right and also not be registerable. In reaching this conclusion, the court followed the views of several writers which held that that a prospecting contract which allowed the prospector to merely go onto the land and search for minerals was a personal right and not a real right. The court rejected the view of Franklin and Kaplan⁷⁰, that the right to prospect on property amounts to a diminution of or subtraction from the full *dominium* of the owner of the property and, therefore, constitutes a real right.

⁶⁸ 1989(1) SA 35 T

⁶⁹ *Vansa Vanadium SA Limited v Registrar of Deeds and Others*, 1979 (2) SA 784

⁷⁰ At page 630

One of the important considerations which influenced the court to hold that the prospecting contract, which was the subject of the case, was not a real right was the fact that the contract could not be registered under the Deeds Registries Act and was not binding on successors in title.

It follows that if a prospecting right (without an option to lease or purchase the mineral right) is a personal right and not a real right then it will also not be included in the concept of ‘immovable property’.

According to van der Merwe,⁷¹ mineral rights are constituted by:

- Reservation on registration of transfer of the property;
- The cession of mineral rights by a notarial deed of cession; and
- The owner obtaining a mineral right distinct from ownership.

The characterisation of a mineral right as a real right is best summarised by van der Walt:⁷²

“Mineral rights are real rights of a unique kind which allow the holder to prospect for, extract and remove minerals on the land in question within the confines of legislation pertaining to mining and minerals. Ownership of the actual minerals is obtained only upon extraction and separation from the land. The mineral rights holder must act reasonably in exploiting the minerals, but in the case of irreconcilable conflict the mineral rights take precedence over the rights of the landowner”.

⁷¹ Van der Merwe, C.G. and du Plessis, J.E. 2004. Introduction to the Law of South Africa. Kluwer International at page 237

⁷² Van der Walt, A.J. and Pienaar, G. 2009. Introduction to the Law of property. Juta and Company Ltd at page 296

6.3 Conclusion

From the above, it is clear that our common-law principles regard a mineral right to be a registerable real right that could be characterised as (incorporeal) immovable property.

The impact of this conclusion shows the conflict between the interpretation of the words ‘immovable property’ as used in paragraph 2 of the Eighth Schedule (ie that ‘immovable property’ is used in a corporeal sense only) and the common-law interpretation that ‘immovable property’ includes incorporeal rights.

Interestingly, from the discussion in this chapter, a second conclusion may be drawn with regard to prospecting rights (without the option to lease or purchase the mineral right). This type of prospecting right is seen to be a personal right which could never qualify as immovable property. If this argument is to be followed then where 80 per cent or more of the market value of a company is attributed to a prospecting right (without the option to lease or purchase the mineral right), paragraph 2 of the Eighth Schedule potentially will not apply to the transaction (and consequently section 35A of the Act will also not find application).

7 Analysis of legal nature of mineral rights encompassed in mineral legislation

7.1 Introduction

As indicated in the previous chapter, it is clear that a mineral right (used as an all encompassing term for mining, prospecting, exploration and production rights) for common-law purposes is a real right that is characterised as incorporeal immovable property. For purposes of completeness, this chapter takes a look at the MPRDA, the currently prevailing legislation for the minerals industry and its predecessor, the 1991 Minerals Act to the establish if these pieces of legislation agree to the common-law principle relating to ‘immovable property’ and mineral rights (and therefore differ from the ITA interpretation thereof),

7.2 Legal nature of mineral rights under the 1991 Minerals Act

A ‘mineral’ was defined broadly in the 1991 Minerals Act as *“any substance, whether in solid, liquid or gaseous form, occurring naturally in or on the earth in or under water or in tailings and having been formed by or subjected to a geological process, excluding water but including sand, stone, rock, gravel and clay, as well as soil, other than topsoil”*.⁷³

A ‘mining right’ was defined in the 1991 Minerals Act to mean *“any right or any share therein acquired under any section mentioned in section 47 (1) or (5) or any right to dig or to mine acquired under a tributing agreement as defined in section 1 of the Mining Titles Registration Act, 1967 (Act 16 of 1967), or any other sub grant acquired by virtue of the first-mentioned right or any share therein”*.⁷⁴

⁷³ Section 1 of the MA

⁷⁴ Section 1 of the MA

Wallis J in the Agri SA SCA case explained that the 1991 Minerals Act was a policy of privatisation and deregulation announced in 1987. Section 5(1) of the 1991 Minerals Act provided for the right to prospect and mine for and to dispose of minerals as follows:

“Subject to the provisions of this Act, the holder of the right to any mineral in respect of land or tailings, as the case may be, or any person who has acquired the consent of such holder ... shall have the right to enter upon such land or the land on which such tailings are situated, as the case may be, together with such persons, plant or equipment as may be required for purposes of prospecting or mining and to prospect and mine for such mineral on or in such land or tailings, as the case may, and to dispose thereof.”

Although it appears that the State did not control the right to mine from a reading section 5(1) above, Wallis J iterates⁷⁵ that a right to mine was conferred on the holders of such mineral rights subject to section 5(2) which exempted persons from the prospecting or mining for minerals without necessary authorisation granted in accordance with the Act. In this regard, the exercise of mineral rights, Wallis J argues was closely regulated in terms of the 1991 Minerals Act and could not therefore be seen to have been a restoration of common-law rights to the holder.

7.3 Legal nature of mineral rights under the MPRDA

On 1 May 2004, the MPRDA heralded in a new dispensation which replaced that which had existed under the 1991 Minerals Act. The MPRDA vests the State with custodianship of South Africa’s mineral resources. In this regard, the preamble to the MPRDA states that *“South Africa’s mineral and petroleum resources belong to the nation and that the State is the custodian thereof”*.

There is some academic debate that the principles enshrined in the 1991 Minerals Act, relating to the private ownership of minerals that vested in the

⁷⁵ Agri SA SCA case (*supra*) at para 64

landowner, were overthrown by the more public recognition that ownership of minerals vested in the people of the country. For the purposes of this document, it is not necessary to decide the validity of this argument.

There was a transition period for a specified period of time, in terms of which the rights held by the landowner (referred to as “old order” rights) remained in force allowing the holder of such rights to apply for a mineral right in terms of the MPRDA. With the new dispensation, rights to minerals can only be transferred with the written approval from the Minister.

Upon consideration of historic mining legislation in South Africa, it is clear that at all time, the State controlled the right to mine (ie it vested in the State) and that such rights are either exercised or allocated by the State. This was also the conclusion reached in the Agri SA SCA case (*supra*).

Section 1 of the MPRDA defines a mineral as “*any substance, whether in solid, liquid or gaseous form, occurring naturally in or on the earth or in or under water and which was formed by or subjected to a geological process, and includes sand, stone, rock, gravel, clay, soil and any mineral occurring in residue stockpiles or in residue deposits*”. Expressly excluded from this definition, is “water, other than water taken from land or sea for extraction of any mineral from such water, petroleum or peat”.

The following definitions, pertaining to the various types of rights that are granted in terms of the MPRDA, are set out below as well as salient features of the rights:

1. In respect of mining activities:

- 1.1 “mining right” means a right to mine granted in terms of section 23(1)

- 1.1.1 Section 23(1) provides that the Minister must grant a mining right to anyone if certain criteria are met;

- 1.1.2 The mining right comes into effect on the date the environmental management programme is approved;⁷⁶ and
- 1.1.3 The mining right is valid for a period that is stipulated in the right and may not exceed 30 years.⁷⁷
- 1.2 “prospecting right” means a right granted in terms of section 17(1)
 - 1.2.1 Section 17(1) provides that the Minister must grant to anyone, a prospecting right, provided certain requirements are met;
 - 1.2.2 The prospecting right becomes effective on the date the environmental management programme is approved;⁷⁸ and
 - 1.2.3 The prospecting right is valid for a period not exceeding five years and such period is specified in the right itself.
- 2. In respect of oil and gas activities:
 - 2.1 “exploration right” means the right granted in terms of section 80
 - 2.1.1 An exclusive right is granted to the holder to explore for petroleum and right to produce same (for testing purposes);
 - 2.1.2 The Minister must grant the exploration right if certain requirements are met in terms of section 80(1) of the MPRDA;
 - 2.1.3 The exploration right provides the holder with an exclusive right to apply for the production right in respect of the petroleum in the area in which the exploration right has been granted;⁷⁹ and

⁷⁶ Section 23(5) of the MPRDA

⁷⁷ Section 23(6) of the MPRDA

⁷⁸ Section 17(5) of the MPRDA

⁷⁹ Section 82(1)(a) of the MPRDA

2.1.4 The exploration right is valid for three years initially⁸⁰ and may be renewed for a maximum of three renewal periods consisting of a maximum of 2 years each⁸¹.

2.2 “production right” means a right granted in terms of section 84

2.2.1 A production right provides the holder with an exclusive right to produce petroleum;

2.2.2 The Minister must grant a production right if certain requirements prescribed in section 84(1) are met;

2.2.3 The production right becomes effective on the date on which the environmental management programme becomes effective⁸²;

2.2.4 The production right is valid for the period specified in the right and may last up to 30 years. The right may be renewed for a further term.⁸³

2.3 “reconnaissance permit” means a permit issued in terms of section 75(1)

2.3.1 A reconnaissance permit allows the holder to conduct speculative seismic or geochemistry surveys on a specific area;

2.3.2 The Minister must issue a reconnaissance permit, in terms of section 75(1) if the prescribed criteria are met; and

2.3.3 The reconnaissance permit is valid for a period not exceeding 12 months and is not exclusive, not transferable and not renewable⁸⁴.

⁸⁰ Section 80(5) of the MPRDA

⁸¹ Section 81(4) of the MPRDA

⁸² Section 84(5) of the MPRDA

⁸³ Section 84(4) of the MPRDA

2.4 “technical co-operation permit” means the technical co-operation permit issued in terms of section 77(1)

2.4.1 A technical co-operation permit allows the holder to conduct an exclusive desk-top study of a specific area utilising existing data;

2.4.2 The Minister must issue the technical co-operation permit, in terms of section 77(1) if the prescribed requirements are met;

2.4.3 The technical co-operation permit is valid for a period not exceeding 12 months and is not transferable and not renewable⁸⁵; and

2.4.4 The holder of the technical co-operation permit has an exclusive right to apply for an exploration right in respect of which the technical co-operation permit relates to.⁸⁶

Section 5 of the MPRDA is titled “Legal Nature of Rights”. The section seeks to qualify the nature of a prospecting, mining, exploration and production right.

It reads as follows:

*“5(1) A prospecting right, mining right, exploration right or production right granted in terms of this Act is a **limited real right** in respect of the mineral or petroleum and the land to which such right relates.*

(2) The holder of a prospecting right, mining right, exploration right or production right is entitled to the rights referred to in this section and such other rights as may be granted to, acquired by or conferred upon such holder on this Act or any other law.

(3) Subject to the Act, any holder of a prospecting right, mining right, exploration right or production right may:

⁸⁴ Section 75(4) of the MPRDA

⁸⁵ Section 77(4) of the MPRDA

⁸⁶ Section 78(1) of the MPRDA

(a) enter the land to which such right relates together with his or her employees, and may bring onto that land any plant, machinery or equipment and build, construct or lay down any surface, underground or under sea infrastructure which may be required for the purposes of prospecting, mining, exploration or production, as the case may be;

(b) prospect, mine, explore or produce, as the case may be, for his or her own account on or under that land for the mineral or petroleum for which such right has been granted;

(c) remove and dispose of any such mineral found during the course of prospecting, mining, exploration or production, as the case may be;

(d) subject to the National Water Act, 1998 (Act No. 36 of 1998), use water from any natural spring, lake, river or stream, situated on, or flowing through, such land or from any excavation previously made and used for prospecting, mining, exploration or production purposes, or sink a well or borehole required for use relating to prospecting, mining, exploration or production on such land; and

(e) carry out any other activity incidental to prospecting, mining, exploration or production operations, which activity does not contravene the provisions of this Act.”(emphasis added)

Interestingly, section 5(1) seeks only to classify prospecting rights, mining rights, exploration rights and production rights as limited real rights. It does not seek to address the legal nature of the reconnaissance permit or the technical co-operation permit. Arguably, these permits in the absence of a classification are not limited real rights.

A common feature that may be derived from the definitions of the various mineral rights that may be granted in terms of the MPRDA is that upon the commencement of the MPRDA, mineral rights can be granted to anybody.

Accordingly, it was found in the Agri SA SCA case that ‘*the holding of mineral rights is no longer the gateway to the exploration of minerals and it is for that reason that the mineral rights have ceased to have value*’⁸⁷. Furthermore, due to the fact that a mineral right is merely an indication of ‘*whom the legislature had chosen to bestow its gift*’, it was found that this is regarded as a statutory right which does not constitute a property right.⁸⁸

A statutory right is not an asset which can be physically touched or seen. However, as a value can be attributed to such a right which the holder can enjoy, and the object to which the right is attached is property, a statutory right is a kin to an incorporeal right. From the foregoing, it can be concluded that a mineral right granted in terms of the MPRDA constitutes a limited real right and is a subtraction from the rights of ownership of a landowner.

7.4 Treatment of mineral rights in the ITA

Having established that ‘immovable property’ in the ordinary sense includes incorporeal real rights and that the various rights granted in terms of the MPRDA are classified as limited real rights (and incorporeal in nature), it is necessary to analyse how the ITA classifies mineral rights throughout the statute, if at all.

Section 1 of the ITA defines “mining operations” and “mining” to include “*every method or process by which any mineral is won from the soil or from any substance or constituent thereof*”. The term ‘mineral’ is not defined in the ITA.

Whilst section 15 of the ITA provides for a deduction from income derived from mining operations of “*an amount to be ascertained under the provisions of*

⁸⁷ Agri SA SCA case (*supra*) at para 115

⁸⁸ Agri case (*supra*) at para 117

section 36, in lieu of the allowances in section 11(e) ...” and section 36 contains various ring-fencing provisions to determine the amount of capital expenditure that may be deducted by a taxpayer in terms of section 15, neither section defines a right in respect of mining.

Section 37 of the ITA which deals with the calculation of capital expenditure on the sale, transfer, lease or cession of mining property, defines ‘mining property’ in terms of section 37(5) to mean “(a) any land on which mining is carried on; or (b) any **right to minerals** (including any right to mine for minerals) and a lease or sub-lease of such right.” (**emphasis added**).

Interestingly, there was a need to distinguish in section 37 in defining “mining property” between land (corporeal) on which mining is carried on and a right (incorporeal) to minerals or to mine for minerals. A definition of ‘immovable property’ in the Eighth Schedule that includes both corporeal and incorporeal property could therefore be added as section 37 defines ‘mining property’ to cast aside any issues of interpretation.

Section 26B of the ITA provides that the taxable income of any oil and gas company, as defined in the Tenth Schedule to the ITA shall be determined in accordance with the ITA but is subject to the provisions of the Tenth Schedule.

Thus, the Tenth Schedule to the ITA sets out special rules that apply to the disposal of an oil and gas right by an “oil and gas company”, as defined.

An “oil and gas company” is defined⁸⁹ as any company –

(a) that –

- holds any oil and gas right; or
- engages in exploration or production in terms of any oil and gas right.

An “oil and gas right”⁹⁰ means –

⁸⁹ Paragraph 1 of the Tenth Schedule

- (a) any reconnaissance permit, technical co-operation permit, exploration right, or production right as defined in section 1 of the MPRDA, or any right or interest therein;
- (b) any exploration right acquired by virtue of a conversion contemplated in item 4 of Schedule II to the MPRDA or any interest therein; or
- (c) any production right acquired by virtue of a conversion contemplated in item 5 of Schedule II to the MPRDA, or any interest therein.

7.5 Conclusion

From the above discussion, it can be summarised that mineral rights have been accepted as real rights and are recognised as incorporeal immovable property in terms of the MPRDA.

However, to iterate with regard to a right to prospect (without the option to either lease or purchase the mineral right to which the right related to), such right is a personal right and can, therefore, not be recognised as immovable property as that term is normally understood. Further, the legal nature of reconnaissance permits and technical co-operation permits is questionable. This has not been examined further in this paper, except as to comment that should a non-resident company be disposing of its shares in an oil and gas company in South Africa, as defined in the Tenth Schedule and 80 per cent or more of the market value of that oil and gas company is attributable to a reconnaissance or technical co-operation permit, it is again arguable as in the case of the prospecting rights, that paragraph 2 of the Eighth Schedule as well as section 35A of the ITA will not apply to such a transaction.

⁹⁰ The various rights and permits set out under (a), (b) and (c) in the definition of “oil and gas right” as defined in section 1 of the MPRDA confirms that the legal nature of an exploration and production right is a limited real right in respect of the petroleum and the land to which such right relates to.

8 Double taxation and treaty relief

8.1 Introduction

The preamble to tax treaties (sometimes referred to as ‘conventions’) usually states that they are entered into between countries “for the avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income and capital gains”⁹¹. When a non-resident disposes of immovable property, that non-resident may be subject to South African income tax on its South African sourced income as well as tax on the same amount in its country of residence. The non-resident would have at its disposal the application of a DTA which may remove or reduce South Africa’s right to tax the income realised on the sale of immovable property.

8.2 Interpretational principles applicable to South African DTAs

DTAs often refer to domestic legislation terms. Article 3(2) is an interpretational clause requiring use of the domestic term when the DTA term is not defined or the context of the term does not provide the necessary definition. Vogel⁹² summaries three problems that may result from changes to domestic legislation referred to by an unchanged DTA as being: (a) the domestic law has been amended; (b) the domestic law carries the same meaning but with a different goal or objective; (c) the new domestic law contradicts the DTA.

Given that South African DTAs are largely based on the OECD⁹³ Model Tax Convention (OECD Model), this paper, whilst looking at the views of other authors, relies mainly on the OECD Commentary when interpreting the provisions of the DTA relating to immovable property. Furthermore, South

⁹¹ Brunetti *et al* (2009)

⁹² Vogel, K. 1997. Klaus Vogel on Double Taxation Conventions – A commentary to the OECD, UN and US Model Conventions for the avoidance of double taxation of income and capital with particular reference to German Treaty Practice. 3rd edition at page 64

⁹³ Organisation for Economic and Co-operative Development

African case law supports the use of the OECD Commentary, albeit as a limited persuasive source of interpretation, when interpreting the provisions of DTAs that South Africa has concluded with other countries.

South African DTAs concluded over the years have also reflected the changes made to the OECD Model from time to time. The OECD Model has also had a direct effect on South African domestic legislation. For instance, the definition of ‘permanent establishment’ in the South African ITA is a direct reference to the OECD Model Article 5 as determined from time to time. It is unclear whether this usage would permit the courts to seek guidance from the OECD Commentary in interpreting the definition. In *SIR v Downing*, reference was made to the lower courts usage of the OECD Commentary, however the judge did not place any reliance on the commentary in the determination of the judgment.

That the South African treaties are largely based on the OECD Model may provide clarity on the status of the Commentaries to the OECD Model in the interpretation of South African DTAs. While the OECD Model has been used by South Africa over the years as a standard template for DTAs, South Africa is not a member of the OECD and has only recently achieved observer status. The use of the OECD Model by South Africa may also reflect the bargaining power of the other Contracting State, rather than a South African approach. Similarly, the South African tax treaty with the United States of America (USA) reflects more of the USA and United Nation (UN) Model Treaties than the OECD. Again, this may refer to the bargaining power of the other Contracting State.

Other Model treaties such as the UN Model and the USA Model occasionally influence the South African negotiators. Generally speaking, the UN Model will have some effect on South African treaties with other African countries whereas the USA Model impact is reserved for negotiations with the USA.

The impact that the commentaries to the UN Model will hold is submitted to be the same as that for the OECD Model. However, the USA Model is unlikely to

be consulted for general interpretation of South African DTAs as only the USA-South Africa DTA is based on the USA Model and supported by a USA Technical Explanation.

The South African courts authority to decide matters involving South African DTAs is in terms of section 108 of the ITA. The section essentially provides that the National Executive may enter into agreement between South African and other countries *“with a view to the prevention, mitigation or discontinuance of the levying, under the laws of the Republic and of such other country, of tax in respect of the same income, profits or gains, or tax imposed in respect of the same donation, or to the rendering of reciprocal assistance in the administration of and collection of the taxes under the said laws of the Republic and of such other country”*. The DTAs acquire the force of law in South Africa in terms of section 231 of the Constitution⁹⁴ after approval by Parliament and publication in the Government Gazette.⁹⁵ Thus having acquired the force of law, DTAs are treated as equal to domestic tax legislation. This equal ranking can create potential difficulties if domestic legislation is in conflict with or is specifically legislated to override the treaty terms.

8.3 Article 6 of the OECD Model

Article 6 of the OECD Model deals with the taxing position in relation to income derived from immovable property. The Article reads as follows:

1. Income derived by a resident of a Contracting State from immovable property (including income from agriculture or forestry) situated in the other Contracting State may be taxed in that other State.
2. The term ‘immovable property’ shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to

⁹⁴ Constitution of the Republic of South Africa, 1996

⁹⁵ Section 108(2) of the ITA

immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircrafts shall not be regarded as immovable property.

3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of immovable property.
4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise.

Paragraph 1 gives the right to tax income from immovable property to the State of the source due to the fact that there is always a very close economic connection between the source of the income and the source State⁹⁶. This is in line with the principle laid down in the *Rhodesia Metals Case*⁹⁷.

Article 6(2), which defines the term ‘immovable property’, states that the meaning which the term has under domestic law shall be ascribed to it for purposes of this provision. The reason for this attribution of definition is stated as follows in the OECD Commentary:

“Defining the concept of immovable property by reference to the law of the State in which the property is situated, as is provided in paragraph 2, will help to avoid difficulties of interpretation over the question whether an asset or a right is to be regarded as immovable property or not. The paragraph, however, specifically mentions the assets and rights which must always be regarded as immovable property. In fact such assets and rights are already treated as immovable property according to the laws or the taxation rules of most OECD member countries. Conversely, the paragraph stipulates that ships, boats and aircraft shall never be

⁹⁶ Paragraph 1 of the OECD Commentary on Article 6(1)

⁹⁷ *supra*

considered as immovable property. No special provision has been included as regards income from indebtedness secured by immovable property, as this question is settled in Article 11.”

Vogel’s ⁹⁸ interpretation of the term ‘law’ as used in Article 6(2) makes reference to the entire law rather than only tax law. The author goes further to state that if the private law of the State, in which the immovable property is situated, attributes a meaning to that term which differs from the meaning it has under tax law, then the meaning it has under tax law shall prevail.⁹⁹

As discussed in previous chapters, the term ‘immovable property’ itself is not defined in the ITA, either generally or specifically. Paragraph 2(2) of the Eighth Schedule to the ITA, however, defines an ‘interest in immovable property’. Olivier and Honiball¹⁰⁰ consider such definition to not be of general application but merely applicable for CGT purposes.

Vogel¹⁰¹ states that according to the second sentence of Article 6(2), the term ‘immovable property’ in any case includes rights to which the provisions of general law respecting landed property apply. This involves corporeal rights in land treated as rights in real property, hereditary leaseholds and mining rights.

Whilst Article 6(2) defines the term ‘immovable property’, Olivier and Honiball¹⁰² argue that it does not deal with the problem where only one of the Contracting States regards the property as immovable property. The authors argue further that the article also gives no guidance on the rules to be followed to determine where the immovable property is situated.

Article 6(3) clearly sets out to cover income from the direct use, letting or use in any other form of immovable property, in other words, income from

⁹⁸ Supra at page 376

⁹⁹ See also Olivier and Honiball (2011:396) wherein it is stated that Article 6(2) is much clearer than Article 3(2) which provides that the domestic law of the country giving up its taxing rights is decisive.

¹⁰⁰ Olivier, L. and Honiball, M. 2008. International Tax – A South African perspective. 2011 at page 396

¹⁰¹ Supra at page 377

¹⁰² Supra at page 396

the exploitation of the land and not, for example, income derived from the disposal of the land.¹⁰³ Thus, in the case of income derived from the exploitation of natural resources, it is clear that Article 6 applies.

In the context of South Africa's rich mineral history and extensive energy and natural resources sector, Olivier and Honiball¹⁰⁴ state that it is clearly beneficial for South Africa to have mining rights as well as mining activities categorised as immovable property as the State in which the mine is situated has the right to tax the income derived from the sale of such immovable property. In the absence of such an inclusion, the authors surmise that the income will have to be dealt with under another article, citing Article 12 (which deals with the taxing right of royalties) as an example. This will, the authors conclude, result in the State of residence having the exclusive right to tax the income arising from such activities.

8.4 Article 13 of the OECD Model

Article 13 of the OECD Model deals with the taxing position in relation to capital gains that arise from the alienation of, *inter alia*, immovable property. Article 13 reads as follows:

1. Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.
2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that other State.

¹⁰³ Olivier and Honiball (*supra*) at page 398

¹⁰⁴ *Supra* at page 398

3. Gains from the alienation of ships or aircraft operated in international traffic boats engaged in inland waterways transport or movable property pertaining to the operation of such ships, aircraft or boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.
4. Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.
5. Gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident.

Article 13(1) clearly provides the taxing right of the capital gain to the State which, prior to the alienation of immovable property disposed of, was entitled to tax both such property and the income derived wherefrom.¹⁰⁵ In other words, with regard to immovable property, the source State has prior right tax the capital gain arising from the alienation thereof.

The OECD Commentary¹⁰⁶ sets out, as a foreword to its commentary on Article 13, that it is left to the domestic law of each Contracting State to decide whether capital gains should be taxed, and if they are taxable, how they are to be taxed. For instance, under domestic law, a percentage of capital gains is included in a taxpayer's income and then taxed at the ordinary income tax rates.¹⁰⁷ In this regard, it must be noted that section 35A is considered to be an advanced payment of the capital gains tax payable by

¹⁰⁵ Vogel (supra) at page 818

¹⁰⁶ Paragraph 1 of the OECD Commentary on Article 13 – Preliminary remarks

¹⁰⁷ Paragraph 10 of the Eighth Schedule read together with section 26A of the ITA

the non-resident on the disposal of immovable property, despite no express mention of CGT in section 35A itself.¹⁰⁸

Thus, it is Article 13 which will either remove or reduce South Africa's taxing right to the capital gain resulting from the disposal of shares in a mineral company.

In the context of defining 'immovable property', especially for purposes of applying DTA relief, Olivier and Honiball¹⁰⁹ cite the Australian case of *FCT v Lamesa Holdings BV* 97 ATC 4752.¹¹⁰ Whilst this is not a South African case, the authors believe that the judgement provides an indication of what constitutes immovable property and would therefore be persuasive authority in South Africa.

The facts were briefly that the taxpayer, a resident of the Netherlands, sold shares in an Australian company which in turn held shares in another Australian company which owned gold mining leases. The question before the Court was whether the disposal by Lamesa resulted in a disposal of the mining leases. If so, then the income from the disposal of the shares had to be dealt with under the capital gains tax article in the Netherlands / Australia DTA. The relevant article provided for the taxation of income from 'real property'. The term 'real property' was defined to include "shares or comparable interest in a company, the assets of which consist wholly or principally of direct interest in or over land in one of the States or rights to exploit or to explore for, natural resources in one of the States". The taxpayer argued that only where the interest is held directly by the alienator the capital gains article will be applicable and not where the interest is held by another company in which the alienator holds shares. The Court agreed.

¹⁰⁸ Olivier and Honiball (supra) at page 399

¹⁰⁹ Supra at page 401

¹¹⁰ See also Avery Jones, J.F. *et al.* 2006. wherein the *FCT* case is cited to demonstrate the different meanings ascribed to "alienation".

The case has since been viewed upon favourably by treaty negotiators looking to extend Article 13 to target interests in interposed companies.

Olivier and Honiball¹¹¹ cite that application of the deeming provision in paragraph 2(2) of the Eighth Schedule to the ITA may be problematic in a treaty context. The question the authors pose is whether the reclassification of the income for domestic law purposes will override the right to which a particular State has under a treaty to tax the income either as business profits or as other income.

8.5 Interplay between Articles 6 and 13 and the domestic legislation

As has been discussed earlier, there is no definition of ‘immovable property’ in the South African tax legislation, save for the definition of ‘interest in immovable property’ for CGT purposes. As has been argued, the reference to ‘immovable property’ in paragraph 2 is problematic as it appears to refer to corporeal property only. Thus, where an ‘interest in immovable property’, ie shares in property-rich South African company are disposed of, paragraph 2 of the ITA may not apply if 80 per cent or more of the value of such shares is attributable to a mineral right (ie incorporeal property). Thus, any gain realised on those shares would not be treated as income arising from the disposal of immovable property under the tax legislation. Accordingly, Article 6 of the DTA would not be applicable.

From an interpretation perspective, Article 6(2) includes a mineral right in the meaning it ascribes to ‘immovable property’. This, again, is in conflict with the manner in which paragraph 2 seeks to define ‘immovable property’ for domestic tax purposes.

Under Article 13(4), the source State may tax capital gains arising from the alienation of shares deriving more than 50% of their value directly from

¹¹¹ Supra at page 402

immovable property situated in the Source State. Article 13(4) applies ordinarily where the non-resident company disposing of their shares in a South African property-rich company is taxed on the capital gain to provide South Africa with sole taxing right to such income. However, if no CGT would apply to this transaction on the basis of the argument put forward in 5.1.2, Article 13(4) would not find application and it would be the State in which the company disposing of the shares is resident that will have taxing rights to the income.

8.6 International tax cases

In the *Vanenburg*¹¹² case, the issue before the courts in Hyderabad, India was whether shares in the Indian company were ‘immovable property’ for purposes of applying section 13(1) of the DTA between India and Netherlands to the gain realised from the alienation thereof. The taxpayer, a Dutch company named Vanenburg Facilities B.V., invested in the equity shares of an Indian company, namely, Vanenburg IT Park Private Limited. The Indian company was engaged in the business of developing, operating and maintain infrastructure facilities of an industrial park. During the 2005 to 2006 years of assessment, the Dutch company sold its 100 per cent shareholding in the Indian company to a non-resident of India. With regard to the withholding taxes, appropriate taxes were withheld by the buyer before making payment of the sale consideration (including interest on the delayed payment thereof).

The Dutch company claimed, as a refund, the taxes so withheld by the buyer when filing its tax return on the basis that the capital gains were not taxable in India in terms of the India-Netherland DTA. The Indian Tax Officer cited domestic tax legislation, in terms of which the shares of the Indian company were defined as ‘immovable property’. Accordingly, the Indian revenue authorities sought to tax the gains arising from the alienation of immovable

¹¹² *Vanenburg Facilities B.V. v. ADIT* (ITA No. 739 & 2118/Hyd/2011)

property under Article 13(1) of the India-Netherlands DTA. On appeal, the Indian Tax Officer's case was upheld.

It was then brought before the Hyderabad Tribunal (an equivalent to the South African High Court). The Court observed that Article 13(1) of the India-Netherlands DTA provided the taxing right to India on gains derived by the Dutch company from the alienation of 'immovable property' referred to in Article 6 and situated in India. As per Article 6(2) of the India-Netherlands DTA, the term 'immovable property', bears the meaning it has under the domestic tax law of India.

On an analysis of the domestic tax provisions, it was found that the term 'immovable property' was not defined generally in the Act. Where the term was defined, it was for specific purposes and had restricted applicability. It was also found that the term, where defined in more than one place in the legislation, had variances to the definition provided for specific purposes and concluded that the specific definition could not be used for general purposes under the legislation. The Court also took into consideration the definition of 'immovable property' under other Acts pertaining to property and found that whilst immovable property included land, buildings or any rights pertaining thereto, it did not include shares in a company.

Since the Dutch company was not sold any immovable property or, more importantly, any rights directly attached to the immovable property, Article 13(1) of the India-Netherlands DTA could not be applied to the disposal of shares. Article 13(4), being the specific provision in the DTA dealing with the sale of shares, was also found not be applicable since the assets of the Indian, which actually is immovable property, remained in the business of the Indian company. Since neither Article 13(1) nor Article 13(4) of the India-Netherlands DTA applied, the capital gains arising on the transfer of shares was found not to be taxable in India. The capital gain would, in fact, only be taxable in Netherlands under Article 13(5) of the India-Netherlands DTA.

This case has outlined the circumstances under which the interpretation of words defined for specific purposes in relation to a general definition under the tax Act will be considered. Interestingly, it was also held that as the income was not liable to be taxed in India, Indian transfer pricing rules did not apply to the transaction which happened between two non-residents. In addition, as the income was not liable to be taxed in India, there was no obligation on the purchaser to withhold tax at the source under the relevant domestic tax legislation. However, even though the resulting tax liability was nil for the Dutch company, it still had to file a return since it was liable to tax in India but by virtue of a treaty.

The problem of valuing assets in mining companies was shown in the recent case of *Resource Capital Fund III LP v Commissioner of Taxation [2013] FCA 363*.

Resource Capital Fund (RCF), a non-resident of Australia, disposed of its shares in an Australian mining company in 2007. The Australian revenue authorities sought to tax the transaction on the basis that the capital gain from the disposal of shares was subject to CGT in Australia (South Africa and Australia's domestic tax legislation is similar in this regard). One of the issues was whether any capital gain could be disregarded on the basis that the market value of the mining company's "taxable Australian real property" (TARP) did not exceed the sum of the market value of the mining company's non-TARP assets.

Whilst in South Africa, the 80 per cent market value test is in respect of all assets to determine whether CGT is applicable to the above transaction, the test under Australian domestic law requires a separate determination of the market value of each of the company's assets.

This case is mentioned here as it provides insight when considering whether a company is a property-rich company or not, whether for domestic tax law purposes or application of a tax treaty that much may depend on the market value methodology that is applied.

8.7 Conclusion

Article 13 speaks of gains realised from the alienation of ‘immovable property’. Those words, in turn, are defined for purposes of the tax treaty in Article 6(2) to include mineral rights. This does not agree to the meaning that paragraph 2 of the Eighth Schedule seeks to ascribe to ‘immovable property’ for domestic tax purposes.

It would favour South Africa to have the common-law interpretation of ‘immovable property’ apply to a mineral right (ie to confirm in legislation that the incorporeal right is ‘immovable property’) since Article 13(4) provides full taxing rights of the capital gain realised on the disposal of shares where 50% or more of the value of the shares is attributable to immovable property in South Africa.

As the *Vanenburg* case shows, the courts will look to the domestic legislation for the meaning of the words ‘immovable property’. If none is found or if it is found, but is defined specifically with restrictive application or variance in meaning, the Court will consider other pieces of legislation to come to its decision. However, if one keeps in mind Vogel’s comment that if the private law of a State in which immovable property is situated attributes a meaning to a term that differs from the meaning it has under tax law, the meaning under the tax law prevails.

Having shown the conflict between the meaning ascribed to ‘immovable property’ in terms of our common-law and tax law in previous chapters, it is quite possible based on Vogel’s argument that the meaning under the tax law prevails for tax treaty purposes, (in this instance that a mineral right is not ‘immovable property’ as set out in paragraph 2(2) of the Eighth Schedule to the ITA) that even if SARS argues that a non-resident is subject to CGT on the transaction involving a sale of shares in a mineral company in South Africa, a tax treaty could well take away South Africa’s taxing right.

9 Conclusion

Paragraph 2 of the Eighth Schedule subjects non-residents to CGT on the disposal of ‘immovable property’ situated in South Africa, which definition includes shares held in a company where 80 per cent or more of the market value of those shares is attributable to immovable property and at least 20 per cent of the share capital is held by that non-resident.

Whilst it is established in common-law and in the MPRDA that mineral rights (encompassing mining, prospecting, exploration and production rights) are real rights of an incorporeal nature and therefore ‘immovable property’ and the DTA includes mineral rights in the definition of ‘immovable property’ in Article 6(2), the conclusion that mineral rights constitute ‘immovable property’ in the Eighth Schedule should not be assumed and bears scrutiny. Thus, with reference to the key question posed in this paper, one could respond simplistically to say that a mineral right is not ‘immovable property’ for purposes of South African tax but is ‘immovable property’ for purposes of DTAs.

Even though, it could be argued that a mineral right could constitute an ‘asset’ as defined in the Eighth Schedule, since incorporeal property is included in the definition of ‘asset’, one cannot ascribe the incorporeal nature of a mineral right to the words ‘immovable property’ as those words are currently used in the Eighth Schedule. As argued, paragraph 2 is absurd in its structure and can only be interpreted to mean that ‘immovable property’ refers to corporeal property each time it is used in that paragraph and that an ‘interest to immovable property’ would therefore refer to an interest in land as opposed to an interest in a mineral right.

The recommendation is that it would be in the best interests of the *fiscus* for the legislators to include a specific definition of ‘immovable property’ that is clear and unambiguous in its meaning so as to include incorporeal real rights such as

mineral rights in the ITA, as is the case with the definition of ‘mining property’ in section 37 of the ITA.

This would have a two-fold effect (i) there would be certainty on the tax treatment for foreign investors when divesting of their mineral assets in South Africa and (ii) the *fiscus* would not be jeopardised if a non-resident company divests its South African mineral assets without paying taxes.

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